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THE VALIDITY OF VOTING TRUST PROVISIONS IN RECENT RAILROAD REORGANIZATIONS.

A voting trust, in the present significance of the term, is a device whereby the legal title to the stock of a corporation is vested in trustees, while the equitable interest in such stock is secured to the real owners and evidenced by certificates of beneficial interest. Such certificates, in accordance with the agreements under which they are issued, secure to their holders every right incident to the ownership of the stock, except the right to vote upon it, which right is reserved to the voting trustees. The apparent purpose of such voting trust is to secure control over, and direct the policy of, the corporation during a definite or indefinite future period. The motives which lead to attempts to effect this purpose are, of course, innumerable. The voting trust, however, has been extensively used to further the plans of the various syndicates which have undertaken recently to reorganize the great railroad systems of this country and to take them out of the hands of receivers. It so happens that the reorganization plans proposed by these syndicates, several of which have already been carried into effect, have adopted

forms of a voting trust almost identical in nature. It is thus in the case of the Northern Pacific System, the Union Pacific System, the Philadelphia and Reading Railroad Company, the St. Louis and San Francisco Railroad Company, and the Erie System. As a matter of fact, the voting trust agreement adopted or to be adopted in these cases has never been directly passed upon by the courts, and questions respecting its validity are consequently of the greatest importance, involving, as they do, financial interests of magnitude.

The voting trust adopted by the new Erie Railroad Company is almost identical, as we have said, with that proposed in the reorganization plans of the above railroad systems. It may therefore be stated as embodying their essential features. According to the reorganization agreement between a Reorganization Committee of three men and all holders of stocks and bonds of the old Erie Railroad Companies, it was provided that the holders should deposit with certain designated depositaries their securities, assigning them to the committee for the purpose of carrying out the agreement. One of the terms of this agreement was that the committee should procure the incorporation of a new Erie Railroad Company, should foreclose certain mortgages and buy in at the sale the old Erie Companies, and should then sell the property so acquired to the newly incorporated company in return for securities to be issued by such company. The holders of the securities in the old company were then to receive from the committee securities in the new company. Those who were entitled to receive the stock of the new company were to receive in place of the ordinary certificates, "certificates of beneficial interest," so-called, corresponding in all respects with ordinary stock certificates except that they did not entitle the holder to vote. This plan was carried into effect by an agreement between the Reorganization Committee of three and three individuals named by such committee to act as Voting Trustees. By such agreement the committee delivered to the Voting Trustees all the certificates which were acquired upon the incorporation of the new Erie Company (reserving a sufficient number to qualify directors), and the Voting Trustees agreed to issue to the

committee stock trust certificates equal in amount to the certificates of stock issued to them. The agreement further provided :

“Second.—On the First day of December, 1900, if the Erie Railroad Company shall then have paid four per cent. cash dividend, in one year, on its first preferred stock and, if not, then so soon as such dividend shall be so paid, or whenever prior to such date, or after such date and prior to such payment of dividend, the Voting Trustees shall decide to make delivery, the Voting Trustees in exchange for, and upon surrender of, any stock trust certificate then outstanding will, in accordance with the terms hereof, deliver proper certificates of stock of the Erie Railroad Company.

“Fifth.—Any Voting Trustee may, at any time, resign by delivering to the other Voting Trustees, in writing, his resignation, to take effect ten days thereafter ; and in every case of death, or resignation, or of the inability of any Voting Trustee to act, the vacancy so occurring shall be filled by the appointment of a successor or successors to be made by the other Voting Trustees by a written instrument ; and the term “Voting Trustees” as herein used shall apply to the parties of the second part and their successors hereunder.

“Sixth.—All questions arising between the Voting Trustees shall from time to time be determined by the decision of the greater number of those then acting as Voting Trustees either at a meeting or by writing with or without meeting, and in like manner they may establish their rules of action.

“Seventh.—In voting the stock held by them, the Voting Trustees will exercise their best judgment from time to time to select suitable directors, to the end that the affairs of the company shall be properly managed and, in voting on other matters which may come before them at any stockholders’ meeting, will exercise like judgment ; but they assume no responsibility in respect to such management or in respect of any action taken pursuant to their votes so cast, it being understood that no Voting Trustee incurs any responsibility by reason of any error of law or any matter or thing done or omitted under this agreement, except for his own individual malfeasance.”

The form of the Erie common stock trust certificate is appended in a footnote.*

* ERIE RAILROAD COMPANY.

COMMON STOCK TRUST CERTIFICATE.

This is to certify that, as hereinafter provided, will be entitled to receive a certificate or certificates for fully-paid shares of one hundred dollars each, in the common capital stock of the Erie Railroad Company, and in the meantime to receive payments equal to the dividends, if any, collected by the undersigned Voting Trustees upon a like number of such shares standing in their names; and, until the actual delivery of such certificates, the Voting Trustees shall possess, and shall be entitled to exercise, all right of every name and nature, including the right to vote, in respect of any and all such stock, it being expressly stipulated that no voting right passes by or under this certificate, or by or under any agreement, expressed or implied.

This certificate is issued under and pursuant and subject to the terms and conditions of a certain agreement dated January 1, 1896, by and between C. H. Coster, Louis Fitzgerald and Anthony J. Thomas, as a Committee, and the undersigned Voting Trustees.

No stock certificates shall be due or deliverable hereunder before the first day of December, 1900, nor until the expiration of such further period, if any, as shall elapse before the Erie Railroad Company, in one year, shall have paid four per cent. cash dividends on its first preferred stock; but the Voting Trustees, in their discretion, may make earlier delivery.

This certificate is transferable only on the books of the undersigned Voting Trustees by the registered holder, either in person or by attorney duly authorized, according to rules established for that purpose by the undersigned Voting Trustees and on surrender hereof; and until so transferred the undersigned Voting Trustees may treat the registered owner as holder hereof for all purposes whatsoever, except that delivery of stock certificates hereunder shall not be made without the surrender hereof.

This certificate is not valid unless duly signed by J. P. Morgan & Co., as agents, and also registered by the Mercantile Trust Company of New York, as registrar.

In Witness Whereof, the undersigned Voting Trustees have caused this certificate to be signed by J. P. Morgan & Co., their duly authorized agents, this.....day of....., 189.

J. PIERPONT MORGAN,
LOUIS FITZGERALD,
C. TENNANT,

Voting Trustees.

By their Agents hereunder,

Registered thisday of....., 189.

MERCANTILE TRUST COMPANY,
Registrar,

By.....

Entered :

Transfer Clerk.

It is our purpose in this paper to discuss the validity of this and similar voting trust agreements. In so doing, our consideration will be confined to cases which are likely in the future to arise involving the legality of the voting trust, and will not extend to a discussion from an abstract standpoint of the *status* of the voting trust. But before beginning the consideration of the law relative to voting trusts in general and the voting trust above set forth in particular, it is necessary to make a preliminary distinction. The motives leading to the creation of a voting trust are, of course, innumerable; and undoubtedly they have had effect upon the minds of the judges when applications for a preliminary injunction against the right of trustees to vote have been made. At the same time, it is apparent that, apart from questions respecting the validity of the voting trust in itself, it will not be allowed to be the instrument to carry into effect some unlawful purpose. That is to say, if a voting trust is made the medium of carrying out an illegal scheme, it will not be allowed to stand even if considered lawful in itself. In *Clark v. Central Railroad and Banking Company of Georgia*, 50 Fed. R. 338 (1892), stock in a railroad company was purchased in the interest of a competing line and was vested in another company as trustee. The law of the state in which the railroad company was situated, forbade the consolidation of competing lines. It was therefore held that the device of the voting trust designed to effect a union of competing lines was void, and the trustee was enjoined from voting upon the stock. It is evident that cases of this nature are not direct authority in determining the *status* of voting trusts in and of themselves.

Possibly the best way of arriving at some understanding of the development of the law upon this subject would be to take up the cases one by one in the order of their decision. Before doing this, however, we should try to gain some idea of the practical reasons leading to the creation of these voting trusts. We will then have our attention drawn to what is significant in the decisions. Each one of these reorganization schemes have followed upon the bankruptcy of the railroad company. Consequently the value of the stock of the road has been in

all the cases but a small fraction of its nominal or par value. And upon the creation of the new company the stock issued in exchange for the old does not represent in value its par. Inasmuch as actual control of the corporation is vested in the stockholders through their voting power, the various bondholders, who have submitted to a reduction in their income, are naturally desirous of seeing the policy of the corporation for the future secured in the hands of those in whom they have confidence. They particularly do not desire that the control of the roads should remain in the hands of a majority of the stockholders, who comprise necessarily a fluctuating body, even if there be no organized effort on the part of some antagonistic interest to obtain control. The voting trust in such a reorganization is therefore a condition inserted for the purpose of securing mortgage bondholders by placing the control in the hands of those whom they trust. In the particular case of Erie, which is not at all exceptional, the provision that there shall be no delivery of stock until the payment of 4 per cent. on the first preferred stock, secures control to the Voting Trustees so long as they shall care to use it. They elect the directors; the directors need not declare a dividend until the Voting Trustees so desire. In the hands of the three Voting Trustees, who have the power to appoint successors, may be prolonged the control over the Erie System forever. They may not have the slightest financial interest in the road nor be representative of any party having a financial interest, yet the control of three men over the Erie Railroad, if the voting trust shall stand, is legally assured for all time, unless they see fit to relinquish it. We turn now to the development of the law as seen in the decisions.

Taylor v. Griswold, 14 N. J. Law, 222 (1834), is the first case of interest to us upon this subject. It arose upon an application to set aside an election for officers of a corporation. One of the points in controversy was whether stockholders might vote upon their stock by proxy. After an elaborate argument, it was decided that at common law no right to vote by proxy existed, and consequently that a corporation had no power to create such a right by its by-laws. This statement

of the common law upon the subject has never been questioned, but the right to vote by proxy is now secured by provisions in the general incorporation acts of the several states. The idea underlying the decision in *Taylor v. Griswold* seems to have been that the issuance of the charter to stockholders was indicative of confidence bestowed in them by the state, and that it was a violation of their duty and beyond their power to delegate the execution of the trust reposed in them by the grant of the franchise. And although this theory has been gradually impaired, yet its effect certainly remains, and the law recognizes a responsibility existing upon each stockholder to use his vote in furtherance of the interest of the corporation, and not solely for his individual interest, ignoring the rights of his fellow stockholders.

In *Brown v. Pacific Mail Steamship Company*, 5 Blatchf. 525 (1865), we meet with the first case in which an agreement in the nature of a voting trust was called into question. Certain stock was vested in Brown Brothers & Co., under an agreement to endure for four years. The parties to this agreement agreed not to sell the stock without first offering it to the remaining parties, and an irrevocable power of attorney to vote the stock was given to Brown Bros. & Co. Certain stockholders, friendly to the interest represented by Brown Bros. & Co., filed a bill for an injunction against certain other stockholders who contemplated applying in a state court for an injunction restraining Brown Bros. & Co. from voting upon the stock vested in their names. In support of this bill it was averred and admitted by the answer that there was a scheme on the part of the defendants looking toward the obtaining of such an injunction from a subservient state judge, with the purpose of enabling a minority to acquire control of the company. The court refused to consider the trust agreement void *in se*, and held that, so long as there was no effort on the part of the beneficial owners to withdraw from the trust, there was no reason why Brown Bros. & Co. should not vote upon the stock in their name. It is apparent, unless the voting trust is *in se* illegal and void, that the decision was a correct one.

In *Fisher v. Bush*, 35 Hun. (N. Y.) 641 (1885), ten stock-

holders in a corporation had agreed not to sell their stock without the consent of all, stipulating that in case of such sale a certain sum should be paid as liquidated damages. Defendant sold, and the remaining stockholders sued for damages. It was held that the agreement was unenforceable, inasmuch as it tended to deprive stockholders of the free exercise of their judgment, and was accordingly against public policy.

Hafer v. New York, Lake Erie, & Western R. R. Company, 14 Wkly Law Bull. (Ohio) 68 (1885), is the first important case upon the subject. Therein an agreement had been made between the Erie Railroad and holders of a majority of stock in another railroad, by the terms of which agreement it was provided that the stock should be registered in the name of the President of the Erie Railroad, who should deliver to an appointee of the directors of that company an irrevocable proxy authorizing him to vote upon his stock. In consideration therefor "pool certificates," so-called, were issued to the stockholders, upon which were guaranteed an annual dividend. A stockholder, not one of the majority who had thus surrendered their certificates, filed a petition praying that the President of the Erie should be enjoined from delivering any proxy to vote, or from voting on the stock registered in his name. It will be apparent from the preliminary distinction taken above respecting contracts unlawful in their ends, that the voting trust in this case was a device for effecting an illegal purpose, and consequently void. And so the court held. They added, however, considerations upon the voting trust itself. "The law," they said, "has confided the care of the franchises and property of this company to the stockholders, and it is the duty of each stockholder to vote for directors of the company with an eye singly to its best interests."

"Here a large number of the stockholders, for a valuable consideration, have attempted to confer their right to vote upon the directors of another company. This transaction, apart from the want of power in the N. Y., L. E. & W. R. R. to enter into it, is plainly illegal. It places in the hands of persons, in this connection unknown to the law, the powers which have been

confided to the stockholders, to be exercised by them according to their judgment, will, and discretion for the joint benefit of all concerned. The law presumes that the pecuniary interest of a stockholder will be a motive to impel him to vote in such a manner as will promote the interests of the company. Such a motive is entirely lacking in one who is not a stockholder, and if such a person be empowered to vote for directors he may be subject to interests and motives other than such as would conduce to the welfare of the company." 19 Wkly Law Bull., at pp. 70-1. Upon this decision a new agreement was entered into, by which a majority of the stock of the subsidiary railroad was placed in the hands of three trustees for the period of five years and as much longer a time as should elapse before it was rescinded by a two-thirds vote of those beneficially interested. "Assignable trust certificates," similar to those adopted in the case of the Erie Railroad Company, were issued to the beneficial holders, securing them all other rights except the right to vote. Certain parties purchased a minority of such trust certificates and tendered them to the trustees, requesting the return of the stock in the company represented by such certificates. This request the trustees refused, and an application for an injunction was made to prevent the trustees from voting on such stock and to compel the transfer of such stock. Such an injunction was granted extending only to the stock represented by the trust certificates. The opinion of the court is interesting. They say: "The agreement made may be finally reduced to this. The entire beneficial interest of the stock is severally vested in the certificate holders, the voting power in the trustees; and the situation does not differ materially from what it would be if the stockholders, retaining their shares, had simply united in a proxy authorizing the trustees to cast the vote of all of them for directors.

"We can perceive no reason why any number of shareholders, either by means of proxy or by vesting the legal title in another, may not authorize him to vote on their stock; and as such is the substance of this agreement, we consider it not illegal. So long as the parties to it, or their successors in interest are satisfied with it, no other person may complain,

and the 'irrevocable clause' does not effect the rights of any one. But if the equitable owner elects to withdraw the legal title from the holder thereof, the case assumes a different aspect. If such demand be not complied with, the party holding the entire beneficial interest in the stock cannot cast the vote thereof, while it may be voted upon by one having no interest in it or in the company ; and so it may come to pass that the ownership of the majority of the stock of a company may be vested in one set of persons and the control of the company irrevocably vested in others. It seems clear that such a state of affairs would be intolerable, and is not contemplated by the law, the universal policy of which is that the control of stock companies shall be and remain with the owners of the stock. The right to vote is an incident of the ownership of stock, and cannot exist apart from it. The owners of these trust-certificates are, in our opinion, the equitable owners of the shares of stock which they represent, and being such, the incidental right to vote upon the stock necessarily pertains to them. They may permit the trustees, as holders of the legal title, to vote in their stead, if they choose, but when they elect to exercise the power themselves, the law will not permit the trustees to refuse it to them :" *Griffith v. Jewett*, 15 Wkly Law Bull. (Ohio) 419, 422, (1886). This amounts to the position that a stockholder cannot irrevocably divest himself by agreement or otherwise of the power to vote on his stock, and that equity will enforce his revocation of such an agreement. It further states as the opinion of the court, that a combination of stockholders, under an agreement vesting the right of voting in trustees, is not illegal in itself and amounts only to the giving of revocable proxies. This opinion is applied in the case of *Zimmerman v. Jewett*, 15 Wkly Law Bull. (Ohio) 423 (1886), which was argued with the case of *Griffith v. Jewett*, 15 Wkly Law Bull. (Ohio) 419 (1886). Therein, the complainant was not a holder of the certificates of beneficial interest but a stockholder who sought to prevent any voting by the trustee upon the stock held by him. His motion for an injunction was denied, and the case of *Hafer v. N. Y., L. E. & W. R. R. Co.*, stated to have gone upon the

ground of the illegal purpose of the voting trust created in that case, where "a majority of the shareholders, for a pecuniary benefit to themselves, transferred the right to vote upon their shares to a party not otherwise interested in the road :" 15 Wkly Law Bull., at p. 423.

Woodruff v. Dubuque, &c., R. R. Co., 30 Fed. R. 91 (1887), is a decision to the same effect, although the facts were slightly different. Therein, in order to carry into effect a plan to sell or lease the railroad, the various stockholders deposited their stock with Drexel, Morgan & Co. under an agreement by which they transferred their stock with power to sell or lease the railroad, securing to themselves by means of negotiable receipts their interest in the stock. Complainants, who had thus deposited their stock, filed a bill praying, first, the return of their stock ; and secondly, an injunction against Drexel, Morgan & Co. restraining them from voting on the remaining stock deposited with them. For the same reasons as those which obtained in *Griffith v. Jewett*, 15 Wkly Law Bull. 419 (1886), the first prayer was granted, while the second was denied. Upon this second prayer the court said : "The other depositors may prefer to have the directors vote or control the vote upon their stock according to the arrangement. If so, that appears to be their right :" 30 Fed. R., at p. 99.

Decisions to the effect that stockholders are entitled to withdraw at their pleasure from a voting trust follow now in several of the State Courts. In *Moses v. Scott*, 84 Ala. 608 (1887), a clause was inserted in the agreement to the effect that no right to vote should accrue to assignees upon the sale of stock placed in a voting trust, and that the trustees should have the right to purchase the stock in preference to any third parties. It was held, however, on an application to enjoin the sale of the stock and right to vote thereon, that the petition must be dismissed. Again, in *Vanderbilt v. Bennett*, 6 Pa. C. C. 193 (1889), which will be considered more in detail below, the actual decision is to the same effect. Similar orders, enforcing the right of stockholders to withdraw from the voting trust, whether they are original parties to the agreement or assignees of such parties,

were made in *Starbuck v. Mercantile Trust Company*, 60 Conn. 553 (1890); in *re Germicide Company*, 65 Hun. (N. Y.) 606 (1892); in *White v. Thomas Inflatable Tire Company*, 52 N. J. Eq. 178 (1893), and in *Harvey v. Linville Improvement Company*, Advance Sheets, N. C. (1896).

It is manifest that these decisions have not involved the determination of the question of the validity of the voting trust in itself. Its validity was attacked directly in the case of *Shelmerdine v. Welsh*, 47 L. I. (Phila. C. P.) 26 (1890), upon the intimations contained in the opinion of which case, voting trust agreements have, it appears, been largely modeled. In that case, under a former reorganization of the Reading Railroad, the securities, bonds and stock were vested in what is known as a "Reconstruction Board," which had power to adjust priorities, fix rates of interest, execute mortgages, give liens for such mortgages, and issue new certificates of stock. Large discretionary powers were given to this board by the depositing bondholders and stockholders, and they were to act with the advice and consent of another body composed of several members, known as the "Voting Trust," in whom, upon the reconstruction, the stock was to be vested. This had been done, and certificates of beneficial interest had been issued. On a Saturday of one week a complainant stockholder moved for an injunction to stay or regulate an election which was to occur on the following Monday, and for an order restraining the voting upon the stock held by the Voting Trustees. The court declined to grant a temporary injunction on the ground that the interests involved were too complex and of too great magnitude to permit of interference upon such short notice. The presiding judge, however, very clearly indicated his opinion upon the merits in the following language: "In considering this question I may begin with a proposition which no one is likely to dispute. Under the statutes of this State, and on general principles, the right to vote on stock cannot be separated from the ownership in such sense that the elective franchise shall be in one man and the entire beneficial interest in another; nor to any extent, unless the circumstances take the case out of the general rule. It

matters not that the end is beneficial and the motive good, because it is not always possible to ascertain objects and motives, and if such a severance were permissible it might be abused. The person who votes must, consequently, be an owner, but it does not follow that he must be the only one. If, for instance, stock is pledged as a collateral, whether the debtor or creditor shall vote depends on the terms on which the pledge is made. The power is, under these circumstances, necessarily to some extent severed from the ownership, and the parties may, consequently, determine on which side it shall lie. So much is conceded on each side of this controversy, and the question is, can the debtor and creditor agree to lodge the vote in some one who is to act for both so long as the debt remains and the stock is held as security for its payment?

"The counsel for the Reading Railroad contended that such a course is not forbidden by any rule or principle. In their opinion there is no reason that forbids a stockholder to transfer his shares to one man as a security for a debt due to another, with a stipulation that the holder shall have the right to vote, and the case would be the same although the intermediary gave the debtor a certificate that the equitable ownership was in him subject to the payment of the amount due. No authority directly in point has been cited on either side, but we incline to think that this view is correct and rules the case in hand. It has, indeed, been argued for the complainants that the power conferred on the members of the voting trust is not coupled with an interest; that they have a dry legal title, with no active duties to perform, and that they should be compelled to transfer the shares standing in their names to the persons who are the beneficial owners.

"We think that this view errs in looking solely towards the stockholders. They are not the only persons beneficially interested in the railroad; the lien creditors are also owners, and, if harmony be not preserved, may possess the whole. It was therefore necessary to have some arbiter to reconcile interests which were jarring and might diverge, and the want was supplied by the voting trust. To decide that the election must be held exclusively on behalf of the holders of the stock certifi-

cates would frustrate rather than give effect to the principle that the votes should be cast by those who have a substantial interest in the result. It is not easy to discern how the position of the members of the trust differs from that of an individual as a security for debt to a third person. The only duty of such a holder is to keep the certificate safely until the debtor pays or is in default, and then hand it over to whichever party is equitably entitled. Had the duties of the Reconstruction Board and Voting Trust been confided to a single body with authority to secure the creditors by executing mortgages and then hold the stock, with a right to vote in the way best calculated to promote the common good, it could hardly have been said that there were no active duties to uphold the trust or that it came to an end when the mortgages were executed. If this would have been the rule in the circumstances above supposed, it does not, we think, vary the case that the end was sought to be obtained through two closely related boards, one supplementing and operating as a restraint on the other : " 47 L. I., at p. 26. The ground taken by the court rests wholly upon the thought that the bondholders and other creditors were entitled to protection, and that, since the stockholders' rights were inferior to theirs, the voting trustees should be allowed to represent the lien holders in voting upon the stock. It is impossible not to perceive that there is a confusion here between the rights of stockholders as individuals and the corporation as an entity. The court regarded the stockholders as debtors and the mortgage bondholders as creditors. But this is to regard the stockholders as constituting the corporation, which is a confusion of thought. As above quoted, the court says that, "it has been argued that the power conferred upon the voting trust is not coupled with an interest and that they ought to be compelled to transfer the shares standing in their names to the persons who are the beneficial owners. We think this view erred in looking solely toward the stockholders, they are not the only persons beneficially interested in the railroad, the lien creditors are also owners." Certainly it is hard to see how the same parties can in their capacity as lien holders be both owners and creditors. But in

any event the question at issue was the right of voting upon the stock, and whether the bondholders might properly be said to own the railroad or not, certainly they could not be said to have an interest in its stock. The stock which was vested in the Voting Trustees was solely owned by the stockholders, and the lien creditors had no interest in that stock. Consequently the Voting Trustees were trustees, so far as the stock was concerned, for the stockholders only. The position taken by the court in this matter is therefore open to grave objection, resting, as it does, upon a confusion of the stockholders as individuals with the debtor corporation. It amounts to holding that because a bondholder has an interest in a railroad he has an interest in its stock.

Vanderbilt v. Bennett, 6 Pa. C. C. 193 (1889), is an especially interesting decision. In this case a voting trust had been created by which a large majority of the stock of a railroad corporation was vested in five trustees jointly. A special book was kept and certificates of beneficial interest were issued representing an equivalent amount of the stock "standing in the names of the trustees in whom is vested the perpetual power to vote same." Complainant demanded the delivery to himself of the stock of the railroad for which he held such beneficial certificates, and filed a bill to enforce his demand. The court, in disposing of the matter, said: "We think that the trust agreement in question is absolutely void as contrary to public policy, and because it substantially amounts to a repeal of our Act of Assembly in regard to the right to vote incident to the ownership of railroad stock. But whether this be so or not, which, as the case stands, is not judicially before us for our determination, we are of the opinion that it is at least revocable by the plaintiff." It will be observed that this case takes a strong ground upon which to rest its decision. The considerations in favor of such decision are, as has been pointed out, that the theory of the corporation implies a duty on the part of each stockholder to cast his vote for the benefit of the corporation, that reliance upon the performance of such duty must be upon the personal interest of such stockholder springing from his ownership of the stock, and that the voting

trust is an attempt to bargain away the right and duty of the stockholder to share in the control of the corporation without consulting the welfare of the remaining stockholders. Such a view is supported in the opinion of the court in *Cone v. Russell*, 48 N. J. Eq. 208 (1891). In this case the complainants held stock, as executors and trustees, in a certain transportation company. This stock, together with the defendant's holdings, constituted a majority. Complainants and defendant thereupon entered into a contract by which the former gave an irrevocable proxy for five years to the defendant to vote on their stock, and the defendant agreed to employ one of complainants at a certain salary. It was held that such an agreement constituted a breach of trust on the complainants' part, that the contract entered into had for its purpose an illegal end, and that the prayer of complainants for an order restraining the defendants from voting upon their stock must be granted. But while so holding, the chancellor also expressly based his decision upon the invalidity of a voting trust in itself. He said: "Where the majority of the stock is owned by one man or set of them, acting in concert, the minority are, to some extent, protected by the natural interest of the majority to promote the real interest of the corporation. But where a person who has little or no actual ownership, has the unrestricted voting power of a majority of the stock, the minority loses this protection, and what may be properly termed the underlying and fundamental understanding and contract upon which the association is founded is abandoned and broken :" 48 N. J. Eq., at p. 214. Thus, although the voting trust was vitiated by the purposes for which it was called into being, the court distinctly based its decision upon the invalidity of the voting trust. Again, *Starbuck v. Mercantile Trust Co.*, 60 Conn. 553 (1890), was likewise a case in which the purposes leading to the creation of the voting trust were tainted with illegality. Upon the application of assignees of trust certificates the court directed the transfer to them of the stock and granted an injunction against the trustees voting on any stock which stood in their names. The opinion of the court is very elaborate, and they base their decision upon the broad ground

of the illegality *in se* of the voting trust where trustees do not represent a beneficial interest in the stock. In the opinion the court say: "It is the policy of our law that an untrammelled power to vote shall be incident to the ownership of the stock, and a contract by which the original owner's power is hampered by a provision therein, that he shall vote just as somebody else dictates, is objectionable. I think it against the policy of the law of this State for a stockholder to contract that his stock shall be voted as some one who has no beneficial interest, or title in or to the stock directs, saving to himself simply the title, the right to dividends, and perhaps the right to cast the vote directed, willing or unwilling, whether it be for his interest, for the interest of other stockholders, of the interest of the corporation or otherwise. This I conceive to be against the policy of the law, whether the power so to vote be for five years or for all time. It is the policy of the law of our State, that ownership of stock shall control the property and the management of the corporation, and this cannot be accomplished, and this good policy is defeated if stockholders are permitted to surrender all their discretion and will, in the important matter of voting, and suffer themselves to be mere passive instruments in the hands of some agent who has no interest in the stock, equitable or legal, and no interest in the general prosperity of the corporation.

"And this is not entirely for the protection of the stockholder himself, but to compel a compliance with the duty which each stockholder owes his fellow-stockholder—to use such power and means as the law and his ownership of stock gave him, so that the general interest of stockholders is protected, and the general welfare of the corporation is sustained, and the business conducted by its agents, managers and officers, so far as may be, upon prudent and honest business principles, and with just as little temptation to and opportunity for fraud and the seeking of individual gains, at the sacrifice of the general welfare, as is possible. This, I take it, is the duty that one stockholder in a corporation owes to his fellow-stockholder, and he cannot be allowed to disburden himself of it in this way. He may shirk it, perhaps, by refusing to

attend stockholders' meetings, or by declining to vote when called upon, but the law will not allow him to strip himself of the power to perform his duty. To this extent, at least, a stockholder stands in a fiduciary relation to his fellow-stockholders. For these reasons I hold that this trust agreement is void as against the policy of the law of this State;" 60 Conn., at pp. 579, 580.

Railway Co. v. State, 49 O. S. 669 (1892), is an interesting case which reached the Ohio court of last resort. It arose upon a *quo warranto* to determine what directors were authorized to act for the company. Certain stock had been deposited by various stockholders with Brown, Shipley & Co. for the purpose of arranging differences between preferred and common stockholders respecting cumulative preferred dividends, and in order to aid in the readjustment of the affairs of the company generally. The agreement of deposit provided that Brown, Shipley & Co. should vote the stock according to the instructions of a stockholders' committee, and should issue beneficial certificates. Directors were elected by votes cast upon this stock, the validity of whose election was intended to be raised by the *quo warranto*. The court held the election legal upon the grounds stated in the following extract from their opinion: "It does not appear that the ownership of the stock and its voting power were separated by the agreement under which the shareholders' committee was appointed and the stock deposited with the depositary therein, Brown, Shipley & Co., and that agreement does not, therefore, constitute what is known as a voting trust. It was at most a convenient method by which distant and widely separated shareholders became enabled directly to participate in the control and management of the company, and from which each could recede at any time and demand the return of his stock without violating any term of the agreement. The depositary is a proxy required to vote the stock as directed by the committee, and he and the committee both derived their power from the shareholders by the same instrument, and, in the end, effectuate their wishes. Such an agreement differs widely from an agreement whereby the stock is placed in the hands of trustees

who are invested with the power of voting it as their interests may dictate, irrespective of the wishes or direction of the owners. Such an agreement as the latter would be void as against the policy of our corporation law :" 49 O. S., at p. 680.

The last case to be considered, and one of considerable importance, is that of *Mobile and Ohio R. R. Co. v. Nicholas*, 12 S. R. 723 (1893). Therein the railroad was in the hands of a receiver and its indebtedness was very great. There were several decrees of foreclosure existing and their execution would have absorbed all the equities of the stockholders. Under these circumstances an agreement was made between the creditors and the stockholders by which the right to vote the stock was vested in trustees, and the creditors' claims vested in the same trustees. A sinking fund was created and debentures were issued to the creditors by the trustees, while the stockholders agreed that the trustees should hold the stock and vote thereon until the payment of the debentures. Certificates were issued to the stockholders that they were entitled to so many shares together with all rights, privileges, dividends and profits, except that such certificates were subject to the power given to the trustees to vote irrevocably upon the said shares until the payment of the said debentures. Certain of the stockholders brought a bill in equity to enforce this right to vote upon their stock, relying upon two grounds : first, that the charter providing that a vote should be given to each stockholder was contravened by the agreement ; second, that the agreement was against public policy. The court answered the first claim by saying that the charter also provided that the vote might be cast by a lawful proxy. But it will be observed that a proxy is universally considered revocable and that the agreement in the present case contemplated an irrevocable power to vote as being vested in the trustees. The court considered the second point relative to the validity of the voting trust at considerable length, and came to the conclusion that all the cases in which the voting trust was considered illegal went upon the ground of the unlawful purpose for which it was created and not upon the ground of intrinsic illegality. They say : " We have examined case after

case, and find generally that the agreements declared void by the courts, where the power to vote was separated from the stockholders and vested in third persons, were under circumstances which showed that the purpose to be accomplished was unlawful,—such as the courts would not sanction if the principal had voted, and not a proxy, and, in case of a mere dry trust, it is held that the stockholder might revoke a power of attorney in form irrevocable : ” 12 S. R., at p. 731.

The court then proceeded to consider the matter upon principle. Quotation is made from Mr. Morawetz’s work on Corporation Law and sentences are taken out of their context, in order to serve as authority against maintaining a distinction between stockholders as individuals and the corporation as an entity. “ We approve,” it is said, “ of his definition of a ‘ corporation,’ that ‘ it is but a collective name for the corporators or members who compose an incorporated association ; ’ it ‘ is really an association of persons : ’ ” 12 S. R., at p. 734. Applying these views to the case of a stockholder, the court continued : “ As a ‘ member of the corporated association,’ the debt of the corporation is his debt, so far as he is a stockholder : ” 12 S. R., at p. 735. “ As a stockholder, he may surrender his voting power, upon proper consideration, and for a proper purpose, to secure the debt of the corporation, which, as a member of the corporate association, is his debt : ” 12 S. R., at p. 735. Following this reasoning, the bill of complainant was dismissed and his right to vote upon stock standing in the name of the trustees denied. It will be observed that this case furnishes the only instance of the refusal of such an application. It is based, like the decision in *Shelmerdine v. Welsh*, 47 L. I. 26 (1890), upon a confusion between the stockholders as individuals with the corporation. At the same time, the facts were such as to appeal to the general sense of justice in the court. The road was only saved from foreclosure and the stockholders from total loss by an agreement whereby the stock and voting power were vested in trustees, whose primary duty it was to protect the creditors of the corporation. The answer to one urging these facts would of course be that no consideration is superior to the

preservation of the integrity of legal principles, but the facts had undoubtedly great weight with the court.

We turn now to sum up, so far as we are able, the results of the decisions we have considered. The objects sought to be obtained in the several cases have been two: first, the enforcement of the right of a stockholder to withdraw from a voting trust agreement; second, the restraining of voting trustees from casting any votes by virtue of a voting trust agreement. In *Railway Co. v. State*, 49 O. S. 669 (1892), it is true that the case arose upon a *quo warranto*, but the agreement was there held not to constitute a voting trust.

Upon the first point the cases have, with the single exception of that of *Mobile & Ohio R. R. Co. v. Nicholas*, 12 S. R. 723 (1893), been unanimous to the effect that at his pleasure the beneficial owner of stock may withdraw from a voting trust, demand the transfer to himself of his stock, and vote upon the same. This right is independent of any clause of irrevocability, and extends to the assignee of an original party to the agreement. It should be observed, however, that in none of these cases had there been a reorganization to carry out which a voting trust was created, and in none of them did there exist considerations which would tend to raise a feeling on the part of the court in favor of the trust; in fact, in most of the cases such considerations made the other way. In *Mobile & Ohio R. R. Co. v. Nicholas*, 12 S. R. 723 (1893), where there was such a reorganization and such considerations existed, the decision was adverse to the stockholders. Likewise it was adverse in *Shelmerdine v. Welsh*, 47 L. I. 26 (1890), upon similar facts, although the prayer in that case sought to prevent the Voting Trustees from voting upon any of the stock registered in their names.

Several of the cases which we have just been studying as contributing to the determination of the law upon the question just considered have contained discussions upon the second question as to the illegality *in se* of a voting trust, and the consequent right of a stockholder to obtain an injunction restraining the voting of all the stock vested in voting trustees. Thus, the *dicta* in *Griffith v. Jewett*, 15 Wkly Law Bull. 419

(1886), and in *Woodruff v. Dubuque, &c., R. R. Co.*, 30 Fed. R. 91 (1887), are to the effect that a voting trust is not illegal in itself, and that no injunction should be granted against Voting Trustees to restrain them from voting the stock vested in them by willing and assenting stockholders. *Zimmerman v. Jewett*, 15 Wkly Law Bull. 423 (1886); *Brown v. Pacific Mail Steamship Co.*, 5 Blatchf. 525 (1865); *Shelmerdine v. Welsh*, 47 L. I. 26 (1890); and *Mobile & Ohio R. R. Co. v. Nicholas*, 12 S. R. 723 (1893), are, moreover, direct decisions to the same effect. There are, however, three cases in opposition: *Vanderbilt v. Bennett*, 6 Pa. C. C. 193 (1889); *Cone v. Russell*, 48 N. J. Eq. 208 (1891); and *Starbuck v. Mercantile Trust Co.*, 60 Conn. 553 (1890). The basis upon which the decision in each is rested is distinctly the intrinsic illegality of a voting trust. The effect of these decisions is, however, weakened by the fact that, in *Vanderbilt v. Bennett*, 6 Pa. C. C. 193 (1889), it has only the force of a *dictum*, while in *Cone v. Russell*, 48 N. J. Eq. 208 (1891), and in *Starbuck v. Mercantile Trust Co.*, 60 Conn. 553 (1890), the voting trust was created to further illegal purposes.

We have now reached the point where we must consider, in the light of the authorities thus gathered together, the validity of the voting trust provisions in recent railroad reorganizations as they have been stated in the case of the Erie Railroad. Recalling the way in which the cases have arisen, the first question that is presented to one's mind respects the right of holders of beneficial trust certificates, as issued by Erie, to demand the transfer to themselves of Erie stock and to vote upon the same. We have seen that the strong tendency of the decisions, and the attitude of the various courts, was in the direction of enforcing such rights upon the facts presented in the reported cases. In the form of voting trust under consideration, however, there are decided differences, whether material or not is a matter for consideration. As has been in detail set forth, the Erie stock was issued to a committee as consideration for the property of the older foreclosed railroad, and was then transferred to three Voting Trustees under an agreement by which these trustees agreed to hold and vote

upon the stock, and to secure the rights of beneficial owners by the issuance of stock trust certificates. In all the reported cases the stock was once held by the stockholders, and a portion of it was afterwards vested by such stockholders in Voting Trustees. Under such circumstances the right to rescind the agreement, whether in terms irrevocable or not, was enforced. But inasmuch as all the stock was vested first in the committee representing the stockholders, who acted according to the express direction of the stockholders in transferring to the Voting Trustees, this difference is seen to be only apparent. The fact that in the agreement under discussion all the stock, and not a portion only, was vested in the trustees would not seem under the decisions to prejudice the rights of a stockholder to withdraw, which will be clear from an examination of the reasoning in the cases as exemplified in the quotation above given from *Griffith v. Jewett*, 15 Wkly Law Bull. 419 (1886). The most important consideration, however, is whether the voting trust under discussion comes within the reasoning which appealed to the court in *Shelmerdine v. Welsh*, 47 L. I. 26 (1890), and *Mobile & Ohio R. R. Co. v. Nicholas*, 12 S. R. 723 (1893). Undoubtedly in these cases and in the voting trusts under discussion, the trust was adopted in order to facilitate reorganization of bankrupt railroads by placing and securing the voting power in the hands of parties friendly to the lien creditors. The reasoning which sustained the decision in the two cases named was that the stockholders were virtually debtors and that, to save their equities, it was proper for them to agree to vest the voting power in parties representative of the creditors. But in the railroad reorganizations like that of Erie under discussion, we are dealing with a *new* corporation, and it is a necessary presumption under the various State statutes and the common law that the stock issued for property is worth its face value. The new railroad must be presumed solvent, otherwise under the so-called "trust-fund doctrine" the stockholders must be considered liable to the extent of the par value of the stock less the actual value of the property exchanged therefor. If, then, the stock of these railroads is to be considered as given

for property worth the par value of the stock, it follows that the *facts* are not such as to bring the voting trusts of these reorganizations under discussion, within the reasoning of the two cases named. The conclusion, therefore, upon the authority of decided cases is inevitable: that the holders of beneficial trust certificates issued according to the recent railroad reorganization plans have a right to demand at their pleasure the transfer to them of the stock represented by such trust certificates and that the courts will enforce such demand and protect their right to vote upon such stock.

Upon the second question: whether upon application of a stockholder a court would enjoin trustees, holding stock as those do in the case of the Erie Railroad, from voting upon such stock, on the ground of the intrinsic illegality of the trust agreement, we have seen that the reported cases are not in accord. And it would be idle to attempt to formulate definite conclusions respecting the weight of authority upon this subject. The considerations drawn from the cases which would be likely to enter into the decision of a court upon such an application should be stated. To begin with, there is no taint of illegality in the motives leading to the creation of voting trust agreements like those under discussion; rather, so far as the business interests to be subserved are concerned, the motives would seem meritorious. On the other hand, the theory which underlay the decisions maintaining the intrinsic illegality of voting trust agreements, was that they were efforts to disregard the confidence implied in the franchise of a corporation and to separate ownership from the voting power and control, and that such efforts tended to produce irresponsibility in the management of corporations. Now, in the Erie voting trust agreement, the clearest ground is laid for such objections. There was an agreement, when the application for a charter was made, that the stock should be vested in parties as Voting Trustees, who needed neither to have nor to represent any other interest in the stock or in the railroad, and whose powers might extend indefinitely. The control so secured was wholly without reference to the interest of the Voting Trustees; and, to emphasize their irresponsibility, the following pro-

visions already quoted, were inserted in the agreement: "Seventh. In voting the stock held by them, the Voting Trustees will exercise their best judgment from time to time to select directors, to the end that the affairs of the company shall be properly managed, and, in voting on other matters which may come before them at any stockholder's meeting, will exercise like judgment; but they assume no responsibility in respect to such management or in respect of any action taken pursuant to their votes so cast, it being understood that no Voting Trustee incurs any responsibility by reason of any error of law or of any matter or thing done or omitted under this agreement, except for his own individual malfeasance." To sustain such an agreement is to sustain the validity of the voting trust in its strongest form.

It only remains for us to add a few comments upon the possible development of the law upon the present subject. We have endeavored to trace the tendencies in the reported cases ; and in them it will have been observed that anything like a definite formulation of conclusions is impossible, that the cases have been largely *nisi prius* decisions and reflect conflicting tendencies. It may, however, be stated with certainty that the effect of the cases is to throw doubt on the ability of counsel for voting trustees to maintain in full effect against legal opposition a voting trust agreement such as that existing in the case of the Erie Railroad. But, while bearing this in mind, there must not be forgotten the great influence in the direction of conservatism, which the financial interests involved impress upon the mind of a judge, tending to make him chary of interference. A judge must inevitably hesitate before he asserts the invalidity of one of the most important provisions in the reorganization of the Erie System, the Northern Pacific System, the Union Pacific System, the Philadelphia and Reading Railroad Co. and the St. Louis & San Francisco Railroad Co. But while thus hesitating and rightly hesitating, he should not allow himself to forget that finally, and in the larger sweep of time, the consequences to flow from the adoption of considerations of expediency must be confusing and disastrous, the consequences to flow from the adoption of true principles, salutary.

Charles H. Burr, jr.